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Ratings

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Summary:

Massachusetts State College Building Authority; School State Program

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Summary:

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US$230.0 mil rfdg rev bnds fed taxable ser 2019 C due 05/01/2043		
Long Term Rating	AA-/Stable	New

Rationale

S&P Global Ratings assigned its 'AA-' long-term rating to the Massachusetts State College Building Authority's (MSCBA) $230 million refunding revenue bonds, series 2019C (federally taxable). S&P Global Ratings also affirmed its 'AA-' rating on $1.2 billion of MSCBA debt outstanding (including the bonds to be refunded) secured by a state aid intercept. The outlook on all ratings is stable.

The 2019C bonds are being issued to refund certain debt outstanding.

We rate the bonds issued by the MSCBA one notch below our general obligation (GO; AA/Stable) rating on the Commonwealth of Massachusetts based on the application of our criteria, titled "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" and "State Credit Enhancement Programs" (published Jan. 22, 2018, and Nov. 13, 2008, respectively), reflecting the commonwealth's commitment to pay debt service on behalf of eligible participants through a statutory aid intercept. Payment of debt service from interceptable appropriations is not subject to allotment risk, however, because support of debt service for these obligations is conditional on the legislature appropriating sufficient funds to state colleges and universities to intercept. The bond agreements do not specify whether there would be any additional general fund support from the state beyond the initial state appropriation to the colleges and universities. In addition, although we consider late budget adoption risk mitigated, given that debt service payments do not fall early in the state's fiscal year, there are some risks related to the efficacy of the program in the event of a prolonged late budget scenario. Nevertheless, we consider the commonwealth involvement, the intended payment source, and political and administrative support to be strong. The enhanced rating on the MSCBA bonds moves in tandem with the GO rating of the commonwealth.

Additional factors supporting the rating include:

- A clearly defined, in our view, notification requirement to the commonwealth regarding sufficiency of funds to cover debt service well in advance of debt service payment dates;
- A requirement of the state comptroller to transfer funds to cover any identified insufficiency from legally available appropriations within five days; this transfer is not subject to allotment; and
- A strong history of state support over time.

MSCBA bonds are secured and payable in the first instance from project revenues (gross revenues from payments of

fees, rents, rates, and other charges for the use and occupancy of any financed projects, such as dormitories, and for the services and facilities they provide). The payments from the state universities are paid to the trustee semiannually, about a month after final room payments are due and at least one month before debt service on authority bonds is due.

Although project revenues are pledged, we base the 'AA-' long-term rating on the strength of the state aid intercept structure. If project revenues are insufficient, state aid to the universities can be intercepted for debt service payments, although this intercept has never needed to be used historically. Notably, full support for debt service under the intercept program is conditional on there being sufficient interceptable appropriations made to state colleges and universities. Based on recent figures, however, we consider there to be ample funds under the intercept program to cover any deficiencies. We calculate interceptable commonwealth appropriations to state colleges and universities of $260.1 million received in fiscal 2019 will cover future maximum annual debt service (MADS) after the sale of the 2019C bonds by 2.50x, which we consider strong. We also calculate budgeted fiscal 2020 appropriations to the state colleges and universities of $274.4 million will cover MADS by 2.64x.

The state aid intercept has been in place since 1998, but in our view statutory changes have enhanced the timing, notification, and mechanics of the program. There is now a statutory requirement for the MSCBA to report to the trustees and the state comptroller on the sufficiency of available funds pledged by the state colleges to pay debt service. This reporting must be done by Sept. 30, and Jan. 31, well in advance of the debt service payment dates scheduled for Nov. 1, and May 1. If the report is not received, the comptroller is directed to prevent any amounts from being expended from the appropriation account of any state college until the comptroller has determined if there is an insufficiency.

Any identified insufficiency would require the comptroller to transfer funds from the appropriation account to cover debt service requirements. The statute was also amended to specify that any required transfers be disbursed, without further allotment, to the trustee under the trust agreement securing the bonds. The statute specifies that such amounts are to be transferred no later than the applicable date for debt service fund deposits required by the trust agreement.

Notably, appropriations from the commonwealth are not transferred directly to the universities. They are held by the comptroller and used to fund college employees' payroll and fringe benefits, which we believe makes the intercept easier to accomplish. In our opinion, there has been a high level of state support for the colleges over time despite some decline through the recent recession.

A statutory change in 2011 allowed state appropriations available to all universities in the system to be available to cover a debt service insufficiency at any one state college. The aggregate state appropriations provide ample coverage for all MSCBA debt. On average, the state colleges spend about half of their total state appropriations by the end of the first half of each fiscal year.

The sale of this bond issue will bring final majority bondholder consent to a pending proposed change in bond provisions that had been previously outstanding, although we do not consider the changes to materially weaken the credit quality of the proposed debt or parity debt outstanding. The first change is that the debt service reserve (DSR) fund will be eliminated for the new and parity debt outstanding. MSCBA indicates it might take several months to develop a plan to apply the released reserves to pay down existing debt and in some cases for capital projects. Due to

the stable timing and coverage provided by the pledged revenues, and the proposed pay down of debt, we do not consider the DSR elimination to be a significant deterioration of credit quality. The second change is an amendment to the permitted investments that will allow funds to be invested in the Massachusetts Municipal Depository Trust (MMDT), which is an investment pool for Massachusetts state and local governments. The MMDT offers two investment choices: a cash portfolio and a short-term bond portfolio. We do not believe this investment change is material to the MSCBA rating.

(For more information on the creditworthiness of the commonwealth, please refer to the full analysis published Sept. 3, 2019, on RatingsDirect.)

Outlook

The stable outlook on the program rating reflects the outlook on the commonwealth GO rating. The rating on the program moves in tandem with the commonwealth GO rating.

The stable outlook on Massachusetts reflects our view that the commonwealth's steady economic growth and proactive management will allow Massachusetts to continue to manage potential budgetary challenges, even if midyear budget shortfalls develop in future fiscal years. We believe the current increase in fiscal year-end 2019 state reserves is the result of small budgeted additions to reserves and extra funds from stronger-than-budgeted revenues. Our outlook anticipates that the commonwealth will budget for close-to-breakeven operations during our two-year outlook horizon, and make midyear budget corrections should revenues weaken, as well as bank a portion of unexpected revenue windfalls in its budget stabilization fund (BSF). At this point in the economic cycle and at the current rating level, we expect Massachusetts to modestly improve its BSF and maintain good balances to prepare for a potential recession.

Upside scenario

Should the commonwealth strengthen its pension funding discipline based on a prudent actuarial basis and retain material budget reserves during periods of economic growth as a matter of budgetary policy, with the aim of sustainably achieving what we view as strong reserve levels, we could raise the rating or revise the outlook.

Downside scenario

We could lower the rating if Massachusetts fails to maintain near-structural balance during periods of economic expansion. Such factors that could further pressure the rating include: Medicaid costs outpacing revenue growth; reduced revenues in recessions due to income-tax cyclicality from above-average high-technology sector employment; the effect of federal tax reform on state and local tax deduction caps in high-tax states; and increasing state fixed costs in excess of revenue growth that might lead to significant structural imbalance and rapidly diminishing reserves.

More specifically, these factors could stress the state's structural balance to the extent that Massachusetts fails to adhere to its plan to increase annual pension contributions by 8.9% per year to amortize unfunded pension liabilities or, if this proves insufficient, to keep Governmental Accounting Standards Board pension funded ratios from materially declining.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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